



COUNTY OF SAN LUIS OBISPO

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ATTACHMENT #1

TO: Nikki Schmidt, Administrative Office

FROM: James P. Erb, Auditor-Controller- Treasurer-Tax Collector

DATE: July 24, 2014

SUBJECT: Auditor-Controller-Treasurer-Tax Collector Response to the 2013-14 Grand Jury Report titled, "County Employee Retirement Plan: Let's Make it Clear"

On June 26, 2014 the San Luis Obispo County Grand Jury issued a report titled "Let's Make it Clear". The report focuses on the disclosure/reporting of the San Luis Obispo County Employees Retirement Plan (Plan), specifically the unfunded liability. Information used by the Grand Jury to develop their findings and recommendations was obtained directly from the County; the Plan's most current Comprehensive Annual Financial Report (CAFR), and the June 2013 Actuarial report. These three reports are posted on the corresponding entity's webpage and are readily available to the general public.

The proper presentation of pension liabilities and pension costs has been a topic of debate in recent years. Governmental financial reporting must follow the requirements set forth by the Governmental Accounting Standards Board (GASB), the County may not set its own reporting standards. GASB prescribes defined reporting standards to promote consistency in financial reporting which enables users to make reliable comparisons of one governmental entity to another.

In addition, the Government Finance Officers Association (GFOA) sponsors a financial statement certification program for government entities nationwide. Receiving the GFOA Certificate of Excellence is a testament to meeting all of the applicable GASB reporting requirements. The County of San Luis Obispo just received its 28th annual Certificate of Excellence in Financial Reporting from GFOA.

The Grand Jury findings and recommendations coincided with the recent release of GASB Statement 68 regarding government pension reporting requirements. One of the major changes that impacts San Luis Obispo County is that the Net Pension Liability (Pension Assets less Pension Obligations = Net Pension Liability) will be reported in the financial statements of the County as well as in the Notes to the financial statements. The Net Pension Liability will be presented as a long term liability on the balance sheet and the supporting detail will continue to be outlined in the Notes to the Financial

Statements. The GASB 68 reporting changes for the County's financial statements will be implemented for Fiscal Year (FY) 2014-15.

Grand Jury Finding 1:

"Although it is consistent with general accepted accounting practices, the unfunded liability is recorded in the notes of the financial statements which make it difficult to understand the totality of unfunded obligations for San Luis Obispo County."

Auditor-Controller-Treasurer-Tax Collector Response:

I agree that pension calculations can be difficult to understand, however, financial statements continue to evolve in an effort to make them more comprehensive and understandable. As mentioned above, in accordance with newly issued GASB Statement 68 the Net Pension Liability will be recorded in County's financial statements beginning FY 2014-15, in addition to the current GASB requirement to present the Net Pension Liability in the notes to the financial statements and Required Supplementary Information. The County will comply with the GASB reporting requirements and the required implementation timeline.

Grand Jury Finding 2:

"The County has a 30-year plan to fully fund the pension liability. It is unclear where the county currently stands in this planned recovery."

Auditor-Controller-Treasurer-Tax Collector Response:

I partially agree. Even though the information is available I can understand it may be difficult to locate. The County fully funds the Annually Required Contribution (ARC) which is computed independently by the Plan's actuary on an annual basis. The ARC is an amount that, if paid on an ongoing basis, would be expected to provide sufficient resources to fund both the normal cost for each year and reducing the unfunded liability. By fully funding the ARC, the County is on track with its 30-year plan to fund the pension liability. The ARC is funded by a combination of employer and employee contributions. . As of the start of 2014, there are 26 years remaining in this 30 year UAAL amortization period. The actuarial report is compiled annually and if needed, recommends adjusting contribution rates to meet the County's retirement obligations. The 2013 Actuarial Valuation included a 30 year projection of the funding of the pension obligations that was referenced by the Grand Jury. The accompanying Attachment 1 to this memo provides an update on this 30 year projection based on the 2014 Actuarial Valuation.

Grand Jury Recommendation 1:

"The Pension Trust administrator and the Auditor-Controller-Treasurer should make available to the Board of Supervisors and the residents of San Luis Obispo County an additional simplified transparent reporting of the totality of the county's pension obligation."

Auditor-Controller-Treasurer-Tax Collector Response:

I partially agree with this recommendation. Determining funding requirements for pensions is a complicated, ever changing calculation performed by actuaries. While it would be difficult to simplify the reporting, there are some changes we can make that will help present the pension obligation with more history in one document.

As previously mentioned the implementation of GASB 68 in FY 2014-15 is intended to provide additional transparency to pension reporting. Currently, there is a table in the CAFR under "Required Supplementary Information" (Attachment 2) which may have been overlooked by the Grand Jury. This table clearly presents the County's total pension obligation over the last three years. GASB 68 requires that the table be expanded from the current 3 years of pension history to include 10 years of pension history. The reader can see the annual changes in the County's total pension obligation. Even though the GASB 68 requirement to record the unfunded liability in the financial statements is not scheduled until FY 2014-15, we are allowed to early-adopt changes to the Required Supplementary Information and present the expand the reporting time period for the attached Schedule of Funding Progress to 10 years. Based on the Grand Jury's recommendation, we will implement this change for the FY 2013-14 CAFR rather than waiting until FY 2014-15. Both the Pension Trust CAFR and the annual actuarial valuation reports referenced by the Grand Jury also had this data in the form of a Schedule of Funding Progress going back to 2001.

In addition, all CAFR's have a portion referred to as the "Statistical Section." GASB and GFOA give government agencies some flexibility in what they choose to report in the Statistical Section beyond some basic requirements. Based on the Grand Jury's recommendation, we will include the 30 year annual actuarial projection (Attachment 1) in the Statistical Section of the CAFR starting with the fiscal year ending June 30, 2014. The 30 year projected performance along with the 10 years of historical data in the Required Supplementary Information (Attachment 2) will provide 40 years of pension information in one document, the County's CAFR.

Grand Jury Recommendation 2:

"A balance sheet report should be provided showing the year to date changes in the actuarial assets and liabilities to assist in tracking the progress of the plan."

Auditor-Controller-Treasurer-Tax Collector Response:

I partially agree with the recommendation. There is already a schedule in the County's CAFR that accomplishes this but it only presents three years of data. Expanding this report to include 10 years of historical data along with the other changes identified in the response to recommendation 1 will provide the year to year changes of pension assets and liabilities in one document. Beginning FY 2014-15, GASB requires the net pension liability to be reported on the balance sheet.

Summary:

There are a number of required checks and balances in place to ensure the County continues to pay 100% of the annual required contributions and is in compliance with

reporting requirements of the Plan. The results of these monitoring mechanisms are available to the public. They include:

- The Pension Trust and County of San Luis Obispo Comprehensive Annual Financial Reports are prepared by staff and audited by outside accounting firms annually.
- There is a seven member Pension Trust Board of Trustees, made up of appointed and elected members, who meet monthly in a public forum.
- Board of Trustee meeting agendas and materials, including past meeting minutes, are available on the Pension Trust website for interested persons who are unable to attend the live presentation.
- Pension Trust Board members are required to take specific training classes and maintain a certain level of continuing education on an annual basis.
- The County goes through rating reviews every two years. The County's General Obligation Bond rating was recently upgraded from AA+ to AAA and the Pension Obligation Bonds were upgraded from AA to AA+. Triple A rating is the highest credit score a governmental agency can obtain.

This Board of Supervisors working with collective bargaining units has done more than any previous Board to reduce annual pension costs which ultimately resulted in the reduction of the long term pension liability. Those changes include:

- Establishing a Tier 2 reduced pension benefit for all new employees before it was required.
- Adopting the State changes implemented by Governor Brown with the Public Employees Pension Reform Act (PEPRA) of 2012. PEPRA created a Tier 3 reduced pension benefit for employees hired after January 1, 2012.
- Providing direction on a 50/50 split between employee and employer for all future pension rate increases.
- Moving final monthly pension calculation from a 12 month average to a 36 month average for Tier 2 and Tier 3.
- Never having allowed pension spiking features such as including vacation, sick leave, or other non-salary items to add to the final pensionable compensation calculation.
- Eliminating the employer pick up from the pension calculation for Tier 2 and Tier 3 pension benefits.
- Approving pension prefunding saving approximately \$1.4 million in FY 2014-15

I agree with the Grand Jury that pension calculations and subsequent reporting is complicated. To fully understand the health of a pension plan requires professional judgment of outside auditors, actuaries, rating agencies (Fitch and Standard and Poor's), and financial advisors. All of this information is available to the public for review. Any questions can be directed to my office or to the Pension Trust Executive Secretary.

I believe we have or will comply with the Grand Jury recommendations by:

- Implementing the reporting requirements of GASB 68
- Expanding the three year history to ten years in the CAFR Required Supplementary Information (Attachment 1)
- Including the actuarial thirty year projection in the Statistical Section of the CAFR (Attachment 2).

I would like to thank the Grand Jury for looking into this important matter. They were helpful and courteous as they conducted their review.